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Soviet Interest in Industrial Reform in Other Communist Countries [redacted] 25X1

A Research Paper

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SOV 86-10043X
September 1986

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Soviet Interest in Industrial Reform in Other Communist Countries

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A Research Paper

This paper was prepared by Office of Soviet Analysis. Comments and queries are welcome and may be directed to the Chief, Domestic Policy Division, SOVA,

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Soviet Interest in Industrial Reform in Other Communist Countries

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Preface

General Secretary Gorbachev has stimulated debate in the USSR over how to improve Soviet economic performance. Soviet officials appear increasingly inclined to look at the experience of other Communist states in their search for ideas. This paper examines Soviet commentary on developments in China, Hungary, and East Germany—focusing especially on the Soviet assessment of the strengths and weaknesses of these countries' industrial reform efforts. While the Soviets' assessment contains hints on the type of changes the commentators would like to implement in their own country, their discussion of Chinese, Hungarian, and East German industrial reforms is only part of an even broader and more controversial debate about the need for change in the USSR. This paper does not attempt to predict the outcome of this debate.

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Soviet Interest in Industrial Reform in Other Communist Countries

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Summary

Information available as of 9 September 1986 was used in this report.

Soviet commentary on Hungarian, Chinese, and East German industrial reforms has increased under General Secretary Gorbachev. Statements and actions by regime spokesmen suggest that this increase reflects the leadership's heightened interest in assessing the benefits and costs of these reforms with an eye to their potential application within the USSR:

- In *Hungary,* the regime's decentralization of industrial management and planning and enhancement of the role of market forces, although poorly implemented, have improved product quality and increased efficiency, but industrial growth has generally been slow, and social and political tensions have been fueled by the inflation and widening income disparities reform has brought about.

- *China*'s more recent and more rapid moves toward decentralization and its opening of industry to market forces have led to skyrocketing industrial growth but also to overinvestment, serious breakdowns in quality control, inflation, a widening gap between rich and poor, and widespread corruption among economic officials.

- *East Germany,* unlike Hungary and China, has given little play to market forces but has opted for a streamlined version of Soviet-style central planning that has contributed to increases in industrial growth and productivity while avoiding the political and social risks inherent in the Chinese and Hungarian reforms.

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Although all three programs have won positive comment from some Soviet observers, Moscow's assessment of the Hungarian and Chinese approaches demonstrates its strong concern about the potential loss of centralized political control through economic decentralization. Most Soviet observers of the Hungarian scene are more impressed with the ideological unorthodoxy, political risks, and economic disruptions inherent in Budapest's policies than with the economic gains they may bring about.

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And, while Soviet commentators note the impressive economic achievements of China's reform efforts, the major focus of their analysis is on the "negative phenomena"—inflation, unemployment, graft, loss of central control—stemming from the reforms.

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Soviet assessments of East Germany's industrial reorganization efforts, in contrast, are uniformly positive. Moscow's attraction to the East German system—which maintains tight central control over economic activity—is manifest in Gorbachev's own public statements extolling the achievements of the East German approach. 25X1

The obvious Soviet preference for the East German "model" mirrors the caution that characterizes measures adopted by the Gorbachev regime at home. Gorbachev and his colleagues still believe the present system can be made to work better. Change in the system—whether based on Communist reform models or other ideas—will in all likelihood come slowly and in piecemeal fashion when the leadership becomes convinced that shifts in investment, better management, and increased discipline will not get the job done:

- Soviet commentators have suggested that Moscow may pick and choose various aspects of the East German, Hungarian, or Chinese experiments rather than adopt an entire program.

- Most Soviet commentators realize that the conditions that have made some of these reforms successful cannot necessarily be duplicated in the USSR. Some Soviet economists acknowledge, for example, that East Germany's success is due, in part, to the smaller size of its economy and the German work ethic. Similarly, Soviet sinologists have pointed out that the types of reforms introduced by Beijing have been possible only because China is a relatively new socialist country. 25X1

Gorbachev has, nonetheless, dramatically increased the pressure to improve industrial performance and appears to be much more inclined to measure it by results than adherence to ideological orthodoxy and past practice. He clearly is pushing his managers to accept more responsibility, exercise initiative, and innovate—features of the reform efforts in the three Communist countries examined. The boldness Gorbachev has shown in changing the style of leadership, opening up cultural expression, making personnel changes, and putting forward new foreign policy initiatives suggests that he will boldly look for ways to achieve similar economic results in the Soviet Union. 25X1

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Given the cultural and systemic differences between the Soviet Union and East Germany, Hungary, and China, the experience of other Communist countries will probably be no more than instructive for the Soviets; the answers to Soviet economic problems will probably—as party secretary Dobrynin reportedly said recently—come from within. But, despite the problems accompanying industrial reform in Eastern Europe and China, the successes achieved in other Communist states in promoting growth, increasing productivity, improving quality, and pushing technological modernization will bolster the arguments of those in the USSR who favor change and push the leadership to find solutions that put the Soviet Union again in the forefront of socialist development.

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Soviet Interest in Industrial Reform in Other Communist Countries

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Gorbachev's Industrial Agenda and Soviet Interest in Reform

General Secretary Mikhail Gorbachev has frequently stated that the improvement of Soviet industrial performance is among his most important domestic policy goals. In particular, Gorbachev has called for an acceleration of industrial growth, an upgrading of industrial technology to world standards, an across-the-board improvement in product quality, an expansion of industrial exports, and a sharp increase in the productivity of the industrial labor force. In an effort to attain these ambitious goals, he has launched a "human factor" campaign to tighten labor discipline and has embarked upon a costly program to modernize industrial plant and equipment. In addition, he has pledged to "reform" the industrial economic system.[1]

Although the General Secretary has provided few specifics on his plans for reform, his statements and actions strongly suggest that he sees the reform experiences of other Communist regimes as a useful source of guidance:

- Gorbachev himself has publicly praised East Germany's management of its economy and has stated that the Soviet Union could learn from Hungary's experience with economic reform.
- The Soviet leader has urged the members of the Council for Mutual Economic Assistance (CEMA) to draw upon each other's experiences in the economic sphere and told the 27th Soviet Party Congress that such exchanges are crucial to the development of socialism.
- Soviet media have ended their near silence on China's economic reforms and have increased the objectivity as well as the frequency of their reporting about them.
- Candidate Politburo member Nikolai Talyzin, formerly deputy chief of a Brezhnev-era task force on "socialist management in the fraternal countries," has been appointed to head an economic commission with a charter that includes the study of foreign management experience.

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Potential Contemporary Models

As Soviet officials and economists have responded to Gorbachev's encouragement to examine other socialist models of industrial reform, they have focused their attention on the changes in management and planning already made or under way in Hungary, China, and East Germany. Soviet commentators have given little indication that Bulgaria, Czechoslovakia, Poland, Romania, and Yugoslavia are regarded as potential models for the USSR, probably because the first four are seen as having accomplished little or nothing with reform and Yugoslavia has pushed changes that would be considered beyond the economic and political pale.

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Hungary

Among the reform models that have been the object of Soviet scrutiny, Hungary's has been uniquely long lived, albeit with temporary retrenchments. In 1968, under the leadership of Janos Kadar, the Hungarians introduced a "New Economic Mechanism" designed to increase industry's productivity, boost industrial

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exports, and make industrial enterprises more responsive to their customers' demands for new and better products. Under the terms of the NEM:

- Enterprises were to move toward a self-financing and self-regulating regime, with their managers given greater responsibility for raising investment funds and greater control over wages.
- Industrial prices were to be made more reflective of actual production costs, and foreign exchange rates were to be made more realistic.
- Some enterprises were to be allowed to engage directly in foreign trade and retain a portion of their hard currency earnings.
- The scope of central planning was to be greatly reduced and enterprises required to generate profits by responding to market signals. Overall output targets, however, were still to be determined by central planners, and investments in infrastructure and defense industries as well as CEMA trade obligations were still to be established at the center.

Resistance to the reforms from party bureaucrats and workers and Soviet skepticism about decentralization led Kadar to pull back from his reform drive in the early 1970s. Recentralizing moves to solve such emerging problems as excessive labor turnover and overinvestment, along with the shocks of oil price rises and the Western recession later in the 1970s, further set back the NEM.

By the end of the 1970s, however, the reintensification of pre-NEM problems renewed interest in reform. A "new phase"—intended to increase enterprise independence, spur competitiveness, and enhance market forces—was inaugurated at the April 1984 Central Committee plenum. The new reforms stressed the need for expanding enterprise powers to determine commodity mix and engage directly in foreign trade; continued the selective breakup of large, inefficient enterprises into smaller units; provided for workers in some industrial enterprises to participate in the selection of enterprise directors and the formulation of investment plans; and began decentralizing the banking system to foster competition and improve capital allocation. In addition, the ministerial bureaucracy was streamlined by melding three industrial ministries into one; the price structure was further rationalized by reducing subsidies and turnover taxes; regulations on price formation were liberalized; and incentives for individual workers and enterprises were enhanced by tying wages more directly to profits.[2]

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According to Western observers of the Hungarian scene and some Hungarian commentators, Budapest's implementation of these "new phase" reforms, as well as of the original 1968 reforms, has been superficial and unfocused, and the country's industrial performance has reflected this. Industrial output grew an average of only about 2 percent from 1975 to 1985. In addition, the economy still suffers from low labor productivity and other problems that prompted the 1968 reforms and is saddled with large debts to the West and 7-percent inflation (according to official Hungarian figures for 1985). To secure a balance-of-payments surplus for servicing Hungary's foreign debt and maintaining its creditworthiness, Budapest has cut back on imports and investment, which has contributed to a stagnation of living standards and a consequent rise in social tensions. In the judgment of some Western observers, political dissidence has also increased as a result of the disappointment of popular expectations that the reforms aroused.

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At the same time, the expanded independence of industrial enterprises to compete with each other for profits at home and abroad is credited by most Western analysts with markedly improving the commodity mix and the quality of manufactured goods. Greater responsiveness to the market has brought supply and demand into better balance and contributed to efficiency by reducing waste; competition, efficiency, and financial discipline should be fostered

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further by the bankruptcy law that took effect on 1 September, allowing the liquidation of chronic loss-making companies. Western visitors to Hungary also note a general atmosphere of energy and initiative among industrial managers that contrasts with the caution and "business-as-usual" approach characteristic of their counterparts in the other, more tightly controlled, East European regimes.

China

Of all the Communist models of industrial reform available to the Soviets, China's is the most far reaching and the one that has enjoyed the greatest recent success. Launched in the late 1970s, the Chinese reform drive initially focused on the agricultural sector. Some experiments with decentralized, profit-oriented industrial reforms, however, were begun in selected Chinese factories in 1979, and "special economic zones" were established to encourage foreign investment at three (ultimately four) Chinese trading centers. Encouraged by the success of these initial industrial reforms, the October 1984 Plenum of the Communist Party formally approved the following set of measures aimed at ensuring continued improvement in industrial performance:

- The scope of central planning was to be reduced and market forces were to be allowed gradually to determine more economic activity; economic stability was to be maintained by means of monetary and fiscal policies.

- Enterprise managers were to be given more authority over planning, marketing, wages, and investment to improve efficiency, productivity, and product quality; vertical monopolies were to be broken up; and competition was to be encouraged among economic units. The state, however, was to continue to control the production and distribution of essential commodities and major investment decisions.

- The role of the government and party in day-to-day business operations was to be reduced.

- While administered pricing was retained for key products, prices of many other products were to fluctuate within bounds set by the government, and prices of nonstaples and minor consumer goods were to be determined by supply and demand alone.

China's industrial reform effort has achieved impressive rates of growth, but the results are disappointing and even disturbing in other respects. Figures on last year's economic performance released by the State Statistical Bureau show 18-percent growth in industrial output. The growth in industrial output in the first two quarters of 1985 was so high, however, that it threatened to overwhelm the existing transportation and commercial systems, which had already been seriously strained by skyrocketing agricultural production. In addition, investment spending has been excessive, increasing 35 percent in 1985 alone. Chinese media commentary suggests that Beijing, while convinced that rapid growth is proof that industrial reforms are working, is concerned that accompanying economic and social tensions ultimately could undermine the reforms. Media reports also indicate that industrial efficiency and product quality may be harmed by rapid growth. 25X1

This success in boosting growth already has had negative side effects. The yearend statistical report acknowledged 9-percent inflation (triple the rate in 1984) and a record $15 billion trade deficit. The drive to make the economy more efficient has resulted in widening income disparities and consumer grumbling over rising food prices. Relaxing economic controls and opening up the economic system to foreign trade and investment have, by the admission of the Chinese themselves, sparked widespread graft, bribery, and other types of economic corruption. 25X1

Earlier this year, in recognition of these problems, the regime decreed that the reform drive be slowed to allow the economic system to adjust to the reforms already introduced. Beijing has made it clear, however, that further reforms are in the offing, perhaps within a year. The session of the Sixth National People's Congress that ended on 12 April endorsed further ambitious reforms to be implemented from 1987 to 1990, reflecting the continued political strength of proreform leaders. 25X1

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East Germany

East Germany, which launched the "New Economic System" in 1963—two years before the Soviets' "Kosygin Reforms" and five years before Hungary's NEM—was the first country in the Soviet Bloc to opt for decentralizing reforms. In 1971, however, the new Honecker regime abandoned this reformist course, among other things, for not having achieved rapid growth and high living standards. East Berlin instead embarked upon a recentralizing course, and over the next several years developed a version of centralized industrial management and planning that is much closer to the Soviet system than to the systems that exist in contemporary Hungary and China. Problems with that system also emerged, however, and since the late 1970s East Germany has made a number of primarily organizational changes designed to improve economic performance.

Under the current East German variant of socialist industrial management and planning: [4]

- The centralized decisionmaking structure is retained, with extensive use of administrative regulations to direct the behavior of enterprises.
- Industrial enterprises are grouped into "combines," which provide greater focus on specific production tasks, promote economies of scale, reduce administrative redundancies, and streamline decisionmaking. Combine directors are granted broad powers to manage the operation of their enterprises, within centrally imposed guidelines, and are personally responsible for their performance, including the accelerated introduction of new technology.
- Many foreign trade enterprises are linked directly to combines to improve coordination and promote exports to hard currency countries.
- New performance criteria designed to cut costs, boost efficiency, and stimulate exports have been introduced.
- New positive and negative financial incentives have been implemented, including increased bonuses and steep wage taxes imposed on combines to reduce wasteful use of labor.

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Although its industry remains inefficient by Western standards, East Germany has recently scored impressive productivity gains. According to our estimates, for example, industrial labor productivity increased nearly 6 percent last year. The government also reported that production costs fell sharply.

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In recent East German writings, the introduction of industrial combines or *Kombinate* (see inset) is accorded much of the credit for the industry's successes. In the judgment of East German officials and economists, the combines represent a successful attempt to secure the benefits of partially decentralized operational management without relinquishing central control over basic policy and resource allocations.

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By "rationalizing" centralization and thus reaffirming it as a principle, rather than calling it into question with decentralizing reforms, the East Germans have avoided the ideological and political debate currently under way in China and the social tensions fed by Hungary's decentralized, but in many respects poorly performing, economic system. According to Western analysts, consumer grumbling, while common in East Germany, is not a serious problem for the regime, and in recent years East Germany's industrial policy has not been politically contentious.

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Soviet Commentary

The Soviet leadership has always been sensitive to developments in other Communist countries, particularly those within the Soviet orbit. For the most part, Soviet interest has been driven by concern that modifying the fundamentals of socialist practice could endanger political control, serve as a bad example for other Communist states, erode Soviet influence, and

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East Germany's Industrial Combines

Industrial combines, or Kombinate, *in East Germany link enterprises that produce the same or similar products, use similar technologies, or represent various stages of the production cycle.*

The major functions of a combine are:

- *To combine in a single entity all the phases of production from research and development to sales.*
- *To give constituent enterprises access to larger investments and better management services than an individual enterprise might be able to secure on its own.*
- *To achieve economies of scale, centralization of some functions for greater efficiency, and pooling of managerial talent.*
- *To speed the flow of information both toward the center and horizontally among enterprises and combines, facilitating coordination.*

Combines are directly subordinate to their respective industrial-branch ministries, which delegate some planning activities to the combine director general but which retain considerable power to intervene at the combine and even enterprise level. Enterprises within a combine retain their status as distinct legal entities and maintain their own management structures and cost accounting (khozraschet), *but many management responsibilities that were formerly the domain of the enterprise director now lie with the combine director general. Usually, a particularly large, efficient, or technologically advanced enterprise will be the headquarters for its combine, and that enterprise's director will be the combine's chief executive. Relieved of some of their former responsibilities, central planning agencies can concentrate on broader strategies for economic development, a refocusing Gorbachev has called for in the Soviet economy.*

Combines draw up their own annual plan proposals in line with indicators provided by the State Planning Commission, but it is unclear how much influence a combine director actually has, as distinct from that of his minister, on details of the final plan for his combine. In addition, East German industry's incentive system lags the combines' progress in allocation of decisionmaking authority and improved information flow.

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provide a possible propaganda windfall to the West. The Soviet regime has used public and private commentary on such developments to signal its concern, reinforce internal opposition to such changes in these countries, and possibly limit the scope for greater experimentation.

While these motives still underlie some Soviet commentary, the Soviet leadership has become more interested in the results of Communist reform efforts as the Kremlin's own economy has lost momentum. Because Moscow has tolerated some tinkering with the standard Soviet formula in Eastern Europe, this experience has become a source of quasi-legitimate ideas for proponents of reform and a practical testbed for them. But, given the fierce opposition in some official Soviet circles to change, Soviet commentary on this experience and its results has become an arena for jousting over internal reform. 25X1

Gorbachev's calls for "radical reform" and "revolutionary change" have intensified this battle of ideas. 25X1
Western visitors to the Soviet Union and Western embassy officials in Moscow have reported that Soviet officials and economists have grown increasingly willing to discuss these reforms in private as well. Proponents and opponents of change know that the ultimate winners of the current debate could gain the upper hand in shaping the evolution of Soviet policies. Even if

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these experiences are not suitable for replication in the USSR, the assessment of their success or failure could spur or retard the search for solutions to the problems that plague the Soviet economy and, more important, affect the pace and direction of change in the Soviet Union.

Mixed Feelings About Hungary's Approach

Although the Soviets have generally acquiesced in Hungary's experiments for almost two decades, their public commentary has long suggested that they have done so only grudgingly. While applauding Hungary's efforts to increase productivity and its success in making its products competitive on international markets, the Soviets have indicated concern that the decentralization of economic decision making and encouragement of private initiative might weaken Hungary's Communist character. During Gorbachev's tenure, the Soviets have continued to react to Hungarian reforms with a mixture of admiring interest and distaste.

Gorbachev himself evidently is of two minds on Budapest's reformist policies. During his visit to Hungary in June 1986, he expressed approval of Budapest's official policy of economic renewal and encouraged further efforts to overcome remaining problems. He did not, however, give Hungarian economic reforms the endorsement the Kadar regime almost certainly had hoped for, or single out measures that could be applied in the Soviet Union or elsewhere in the Bloc (see inset).

To judge from both public and private Soviet comment, many Soviet officials and economists are much more impressed with the ideological unorthodoxy and

Mikhail Gorbachev on the Hungarian Economy

This is not the first time I have been in Budapest; and the latest meeting in your beautiful capital and acquaintance with the factory are grounds for saying that the country is living at a good working pace. Here, with you in Csepel, one feels that atmosphere that I know so well from meetings with Soviet labor collectives, of taking an interest not only in the affairs of one's own enterprise, but also in those of the country. The desire to work not in the old way, but as the present time requires, is apparent.

The Soviet Union's course is clear. It has been approved by the congress, by the whole party, by the people. But the tactics, methods, and forms of implementation of the course mapped out are still to be finally developed and specified on the basis, of course, of everything that has been verified in practice in our country as well as in the fraternal countries. The countries of the socialist community have one more source of acceleration that our party intends to use, and to a fuller extent. This is the exchange of experience in building up socialism. The CPSU regards with attention and respect the search for solutions to difficult economic and social tasks that is being conducted in your country, in Hungary, and in other socialist countries. We are glad to see achievements of friends and try to take everything that is useful and suitable for our country. It goes without saying—and we know it from our own experience—that nobody is completely ensured against failures and miscalculations. But we Communists have a decisive criterion of the justification of the experiment, of its rightness. This criterion is the strengthening of socialism in practice, in all spheres—economic, political, and spiritual.

Address at Csepel Machine
Tool Works, Hungary,
9 June 1986

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political risks inherent in Budapest's industrial policies than they are with its potential economic benefits. In June 1985 a Soviet political commentator using the pseudonym "O. Vladimirov" attacked "revisionist, nationalist concepts" such as economic decentralization and greater use of the market mechanism. The article was widely interpreted by Hungarian officials as an attack on Budapest's policies. The Hungarians' concern grew when, several days later, Yegor Ligachev, the number-two man in the Soviet party leadership, sounded the same themes in a speech. Soviet officials reportedly reassured the Hungarians subsequently that the Vladimirov article was not an authoritative statement of Soviet policy. Further, in October in the Soviet journal *Kommunist,* the deputy Secretary General of the Hungarian party published a lengthy article on Hungary's economic successes that was seen by some in Eastern Europe as a rebuttal to Vladimirov.

Nonetheless, some Soviets have continued to voice sharp criticism of Hungary's reforms. For example, in an interview last October in the Italian Communist Party newspaper *L'Unita*, Leonid Abalkin—then head of the Political Economy Department of the CPSU Central Committee's Academy of Social Sciences and now head of the Academy of Sciences Institute of Economics—castigated Hungary's encouragement of small, even more market-oriented enterprises as a "resurgence of capitalism."

Some Soviet officials and academics have also criticized the Hungarian reforms on strictly economic grounds. A senior official of the Academy of Sciences International Institute of the Economics of the World Socialist System (IEMSS) told that the Hungarian system had failed to improve living standards and had allowed an unconscionably high level of inflation.

Hungary's reforms, however, continue to have enthusiastic Soviet defenders.

Significantly, Soviet media have praised Hungary's economic achievements in those areas in which the Gorbachev regime sees room for improvement in the Soviet Union. In August 1985, *Izvestiya*, for example, described the Hungarians' success in putting their scientific research institutes on more of a self-financing basis, thereby saving state funds and promoting the application of scientific and technological advances to industrial production. The Soviets adopted a similar approach to research self-financing at about the same time as the Hungarians but evidently have either been unable or unwilling to implement it consistently. 25X1

Moscow also has commended Budapest's successes in raising industrial efficiency. In late December, a yearend review article on Hungary in *Pravda* praised Budapest's efforts in reducing resource use. An article in *Izvestiya* last April cited a Hungarian official approvingly for urging further technological progress as an important path to resource conservation. 25X1 25X1

The Soviet press has also had some recent praise for Hungarian enterprise independence. In a lengthy article in the Soviet journal *Socialist Industry* in early June, a "special correspondent" hailed the freedom of Hungarian enterprises—"greater than in our country"—to determine their own economic activities, respond to market signals, and satisfy consumers' demands. Even the right of enterprises to help choose their own directors and the refusal of the government to subsidize chronically inefficient and unprofitable enterprises were noted approvingly. 25X1 25X1

Some Soviet economists and academics have willingly speculated that aspects of the Hungarian reform experience could have application to the Soviet Union—almost always, however, portraying Hungary's reforms as a collection of potentially transferable units rather than as an indivisible system. The Soviets also acknowledge that differences in size and culture between the two countries most likely would impede the Soviet Union's borrowing from Hungary. The Hungarian economy is so small, for example, that there are only a few enterprises in many branches of production, and the process of decentralization thus 25X1 25X1 25X1 25X1 25X1

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has proved to be controllable. In addition, Soviet sociologists have noted Hungarian workers' willingness to put in long hours and extra effort to improve their lot, something these sociologists contend the "average Russian worker" is unwilling to do.

Strong Reservations About China's Reforms

Moscow's public comment on China's economic reforms has grown markedly since Gorbachev came to power and has been even more frequent since the recent Soviet party congress. Although due, in part, to the Soviets' desire to affirm a strong interest in improving political relations with Beijing, this increase in commentary probably also is a response to the new regime's efforts to encourage domestic discussion of possible paths to Soviet economic reform.

Soviet media regularly have noted the impressive growth figures racked up by Chinese industry. In mid-March, *Pravda*, for example, recited China's official figures for 1985 output, productivity, and average worker's income, and noted that "(plan) targets were mainly fulfilled or overfulfilled." Outspoken supporters of the Chinese reforms, such as journalist Fedor Burlatskiy, have published enthusiastic reports on the booming economy and the happier and more prosperous Chinese population.

Usually, however, Soviet commentary focuses on inflation, unemployment, graft, and the other "negative phenomena" produced by Beijing's sweeping economic reform drive. Widening income disparities have figured particularly prominently in Moscow's appraisals. The Soviets have also noted the economic costs of China's pursuit of rapid growth. An article in *Ekonomicheskaia Gazeta* in June criticized the "poor quality of output, low economic efficiency, and recurrences of disproportionate pursuit of higher growth rates and expansion of the scale of capital construction to the detriment of improved structure of production and with no consideration for society's financial and material potential." The Gorbachev regime, which is itself intent on boosting growth, may see particularly disturbing lessons in this aspect of China's recent experience with reform.

In appraising the Chinese scene in their media, the Soviets employ the familiar tactic of quoting indigenous critics rather than expressing criticism themselves. Last September, for example, TASS was able to cite Deng as well as Chen Yun, a critic of the reforms whose outspoken comments on Beijing's policies the Soviets often quote: "Deng Xiaoping in his speech noted 'phenomena of bourgeois liberalization, degradation, and decay,' which appeared as a result of the abuses that came in the wake of economic reforms. Chen Yun in his speech noted the spreading 'harmful craze which undermines the party's prestige.' " The Chinese leadership's willingness to permit open debate on economic and ideological issues provides Soviet critics with much grist for their mill.

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The private views of Soviet officials, economists, and scholars on the Chinese reforms cover a far broader range than those presented in the media. Some experts echo the economic, political, and ideological concerns expressed in the press. A senior researcher at the USA Institute told US Embassy officials last November that China's attempt to find a middle road between the "two extremes"—that of central planning, as exemplified by the Soviet economy, and the free play of market forces as in the United States—was doomed to failure and that Beijing ultimately would have to choose one or the other. Shortly after his appointment in July 1985, the new director of the Academy of Sciences Far East Institute (IFE) told a visiting US official that China's new economic policies were promoting social instability and discontent.

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Other Soviet observers, however, have been more enthusiastic about the profound changes taking place in China, and some have been openly hopeful that the Soviet leadership may be inspired to undertake similarly broad reforms. In early February, the head of the Far Eastern Department of the Institute on Scientific Information in the Social Sciences told a visiting US sinologist that the Chinese economic reforms were "reasonable and healthy," and IFE scholars assured the same visitor that an abiding commitment to socialism underlay the reforms.

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In the period just after the October 1984 Chinese party plenum, Moscow was studying the new reform measures with an eye to their possible application to Soviet economic problems. The Soviets have evinced particular interest in Beijing's alleged success in gaining access to Western technology. Soviet discussions with the Japanese in the spring of 1986 about possible joint ventures and—according to Chinese media—hints at Soviet willingness to establish free trade "special economic zones" may, in part, have been inspired by well-publicized Chinese efforts in these areas.

Most Soviet experts willing to discuss the applicability of China's reforms to the Soviet economy, however, have discounted the prospect of Soviet emulation of China, stressing the gulf between the two countries' respective levels of economic development.

Cultural and historical differences make it even less likely that the Soviets would be willing or able to follow the Chinese path. A prominent Soviet journalist told US Embassy officials shortly after Gorbachev's accession that the type of reforms introduced by Beijing was possible only because China was a "relatively new socialist country." The political implications of China's "mad rush into an unmanageable economic mishmash," as one Soviet sinologist has described it, are also disturbing to the Soviets.

The Soviets clearly are unwilling to make the psychological leap of according China's reformed economy the status of a "model" that they or other Communist countries might emulate. From the Soviets' viewpoint, the scope, speed, and nature of the changes in China—the world's most populous Communist state—and the attention given these changes by foreign media must make Beijing's reforms appear a more formidable challenge to their own economic model and to their role as the leading Communist state than Hungary's struggling 20-year-old reform program. The possibility that the Chinese could make a great success of their experiment, not only discrediting Moscow's more measured approach but also building up even more formidable economic and military strength and moving closer to the West, almost certainly is disquieting to the Soviets. 25X1 25X1

High-Level Praise for the East German System

Since Gorbachev's election as General Secretary, the Soviet attitude toward East Germany's management and planning system and its industrial performance has been one of unqualified approval and encouragement. Gorbachev himself has publicly praised the East Germans' management of their economy (see inset). 25X1 25X1

In addition, the Soviets have provided the East German leadership with a forum in which to sing its own praises. In October 1985, for example, Honecker expatiated in *Pravda* on his country's economic performance in an article so lengthy and detailed it appeared that the Soviets were holding up East Germany as an example to other socialist countries. More recently, on the eve of the CPSU party congress, Politburo member and Party Secretary for Economics Mittag was permitted to hold forth at equal length on East German economic success in an article in *Izvestiya*. Honecker also delivered a speech to the Soviet party congress that emphasized the accomplishments of East German industry. 25X11 25X1

Much Soviet commentary on the East German economy, like statements by the East Germans themselves, credits the combine system with "rationalizing production" and generally improving industrial performance. In April 1985 in *Izvestiya*, Otto Latsis, an economist at the institute International Economy of the World Socialist System, called for increased

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Mikhail Gorbachev on the East German Economy

In 1966 I went with a party delegation to the GDR to study the experience of work on the party bodies' management of economic reform. I was greatly impressed by what our friends had accomplished **even then** (emphasis added). In all the main directions of their output, they determined where—in what country—the highest indices and the best quality were, and they set themselves the task of surpassing them—and in productivity, too—in order to become more cheaply competitive, but—and this is the main thing—on reliability and quality of articles as well. You know, this set everything in motion. Each factory and each association should know the indices and the achievements for their products in the advanced countries.

Speech in Leningrad to Party *aktiv*,
17 May 1985

Many people remember that at one time, when the [Soviet] associations were being organized, instructions were given that they should be set up on the basis of enterprises, irrespective of the departments and territorial units to which these belonged. But, in fact, associations were created not even within the framework of ministries for particular industries, but within the framework of all-union production associations. Under limited conditions like those, naturally it was not possible to form a rational and effective network of associations. Now the formation of interindustry associations must be supported in every way. This is a promising thing, as is shown by the experience of the fraternal countries, and first and foremost that of the GDR.

Address to Conference on Scientific
and Technological Progress,
11 June 1985

It is with close attention that (the Soviet people) have listened to the SED Central Committee's progress report delivered by Comrade Erich Honecker and familiarized ourselves with directives on the plan for the GDR's national economic development in 1986 through 1990. They are convincing evidence that the cause of socialism on German soil is making confident headway. Your plans are challenging but realistic because they are based on the tangible results achieved both throughout the history of this republic and over recent years. Intensive methods have made it possible to ensure a steady pace of national economic advancement. Your experience of merging science with production, making rational use of material and manpower resources, and applying the achievements of scientific and technological progress deserves wide praise.

Address to East German Communist
Party (SED) Congress, 18 April 1986

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power for production associations (organized groups of enterprises analogous but not identical to the East German combines), citing the success of such organizations in East Germany and elsewhere in Eastern Europe. An article in the September 1985 issue of the Soviet trade union journal described the combine system as "a dialectical unity of independent economic enterprises and centralized planned management."

The Soviets have openly discussed the combine system as a model for Soviet industry. In two articles in late summer 1985, Gorbachev's reported economic adviser, Abel Aganbegyan, advocated the regrouping of enterprises into large new "science and production associations" explicitly modeled on East German combines. The Politburo in mid-December did, in

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fact, announce the formation of interbranch science and technology complexes, but their ultimate structure and functions remain unclear.

In early January, *Pravda* noted East Germany's success in "improving production relations," not only by means of the combines, but also through the set of supplementary economic indicators introduced in early 1984: net output, output of consumer goods and services, output of goods for export, and net profits. Soviet commentary has also focused on East Germany's ability to reduce its use of energy and raw materials. Overall, Soviet media find East Germany a "highly, dynamically developed economy which is constantly augmenting its economic potential."

The Soviets' concern about the possible loss of political control through economic reform—apparent in Moscow's attitude toward Hungary and China—is no doubt one of the reasons the East German "model" is so appealing. The fact that centralization has not only been reaffirmed but also strengthened by East Berlin's efforts to streamline and improve its economic management mechanism probably gives Moscow hope that it can achieve the same results without paying any political costs.

In private discussion of the East German approach to industrial management, Soviet economists have echoed Moscow's public praise and described East Berlin's methods as having applicability to the Soviet economy. Still, although full of praise for the East German system and willing to speculate about the adaptation of certain East German methods, many Soviet economists and other academics have expressed skepticism about the success of a total transfiguration of the Soviet economic system along East German lines. Most of this pessimism has focused on the respective levels of skill, dedication, and individual enterprise of German workers and managers and their Soviet counterparts.

Prospects and Implications

In light of such expressions of skepticism—and the even stronger Soviet reservations about the applicability of the Hungarian and Chinese reform programs to the USSR—the Soviet Union is unlikely to opt for the wholesale adoption of any other country's approach to the improvement of its industrial management and planning system. As a Soviet commentator recently told a Hungarian television audience, the Soviets "intend to solve their own problems starting out from their own experiences."

Still, as the same commentator also suggested, the Soviets evidently see merit in what might be termed a "smorgasbord" approach to reform: borrowing and adapting specific measures to address specific economic problems, rather than adopting a new economic system wholesale. To judge from what Gorbachev himself has said, the foreign socialist management innovation that the Soviets are most likely to emulate is the East German system of industrial combines. Less authoritative Soviet commentary also suggests that Moscow might imitate Hungary's and China's moves to strengthen the financial independence of industrial enterprises and to promote industrial joint ventures with Western firms. In each of these cases, however, it is doubtful that the Soviets would be able or inclined to reproduce the conditions that have contributed to whatever success these measures have enjoyed in East Germany, Hungary, and China.

Even if East Germany's industrial management structure could be duplicated in the USSR, for example, the great difference in size between the Soviet and East German economies could prevent replication of some of the more successful elements of the combine system. One important means by which the East German leadership ensures the effective functioning of the two-tier, ministry-combine structure is semiannual meetings in East Berlin with all the combine directors in the country. An equivalent convention in the Soviet Union would be so huge that it would be unmanageable. The Soviet leadership would have to fall back on its traditional methods of addressing large gatherings and disseminating written directives, which preclude the very sort of input from below that distinguishes the East German system.

Another likely constraint on Soviet success with the East German "model" would be the Soviet system's lack of the elusive quality of "Germanness." Removed

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from the unique matrix of political expectations, social aspirations, and cultural predilections in which they developed, East German economic methods could have unpredictable results or wither entirely. The Soviets could theoretically improve the basic education of their work force and establish an apprenticeship system to train it more thoroughly, as the East Germans have done. They could also, as seems likely, press forward with their "human factor" campaign. But the question remains whether they could make workers less corrupt, better disciplined . . . more "German."

Soviet efforts to strengthen the financial independence of industrial enterprises along Hungarian and Chinese lines would also be likely to encounter problems. To judge from accounts in the open press, Soviet officials and economists have been favorably impressed with the positive impact that enhancing enterprise financial independence has had on industrial performance in Hungary and China alike. The Soviets have had particular praise for Budapest's success in reducing wasteful use of equipment, labor, and materials by requiring industrial enterprises and scientific research institutes to finance their own operations and a portion of their investment and allowing them to retain much of what they save from economizing on resources.

At the same time, the Soviets have expressed reluctance to accompany such an expansion of enterprise responsibilities with an expansion of enterprise rights in such areas as the setting of prices and the firing of unneeded personnel—moves that are an important part of Hungarian-style self-financing. The Soviets' reluctance to do so is understandable, for such moves run the risk of contributing to inflation and unemployment. Still, in the absence of such accompanying measures, Soviet emulation of Hungarian efforts to enhance enterprise independence from central planners would be unlikely to yield comparable resource savings.

Similar problems would cloud the prospects for Soviet emulation of China's mixed experience with special economic zones (see inset) and joint ventures between its industrial enterprises and Western firms. Soviet leaders recognize the potential benefits for the Soviet Union in the implementation of such ventures, and feelers have been put out to some Western firms. Moscow almost certainly would find the prospect of direct legal access to Western technology and expertise appealing. It is highly unlikely, however, that the Soviets would be willing to concede to potential Western partners the rights and status they enjoy in joint ventures with the Chinese. 25X1 25X1 25X1 25X1

the Soviets would be loath to cede any control over the operations of an enterprise on Soviet soil. 25X1

The Soviets' obvious preference for the East German approach mirrors the caution reflected in the measures so far adopted at home. Gorbachev and company apparently believe that more can be done with the current Soviet system. 25X1 25X1

The boldness Gorbachev has shown in changing the style of leadership, opening up cultural expression, making personnel changes, and putting forward new foreign policy initiatives, however, suggests that he will aggressively look for ways to improve Soviet economic performance. He is pushing his managers to accept more responsibility, exercise initiative, and innovate—features of the reform efforts in the three Communist countries examined. Given the cultural and systemic differences between the Soviet Union and its Communist neighbors, the experience of the other three Communist countries will probably be no more than instructive; the answers to Soviet economic problems will probably 25X1

come from within. Still, the successes achieved in these other Communist states in promoting growth, increasing productivity, improving quality, and pushing technological modernization will bolster the argument of those in the USSR who favor change and will push the leadership to find solutions that put the Soviet Union again in the forefront of socialist development. 25X1 25X1 25X1

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China's Special Economic Zones

China's four special economic zones (SEZs) were established in 1979 as the flagships of Deng Xiaoping's policy of "opening to the outside." By far the largest of the SEZs is Shenzhen, initially a small fishing village bordering Hong Kong that has grown in the past six years into a city of more than 250,000 residents.

The SEZs were designed to act as "windows" through which the Chinese could study advanced Western production technology and management methods, while keeping out undesirable aspects of Western culture. More than simple export processing zones, the SEZs are cities with special administrative status in which the Chinese allow a hybrid of capitalist and socialist systems to exist. The Chinese expected to attract investment in the SEZs by Western manufacturers through a combination of tax breaks, reduced redtape, and modern infrastructure. After an initial period of Chinese investment in infrastructure, the SEZs were to generate foreign exchange for the Chinese by catering to the export market.

Mounting problems, however, forced Deng to publicly admit in early 1985 that the SEZs had not yet turned out the way he had hoped:

- *Despite great expenditures to develop infrastructure, the SEZs have attracted little Western manufacturing investment. China's hopes of gaining access to Western production technology through the SEZs have remained largely unfulfilled, outside of a few showcase projects.*
- *Instead of generating foreign exchange, the SEZs have become net drains on China's foreign exchange reserves: in 1984, roughly two-thirds of Shenzhen's production was being sold in China's domestic market.*
- *The zones have become centers for black-market currency speculation, smuggling, and other forms of corruption, much of it carried on by Chinese officials.*

Problems with the SEZs have provided a rallying point for critics of Deng's "opening to the outside." Some Chinese officials have used these problems to express their discontent over the inequities of China's recent foreign trade policies and have charged that Beijing has lost control over foreign trade by granting too much trade autonomy to localities. Deng himself withdrew his wholehearted support from the SEZs.

China will not abandon the SEZs, but the zones no longer enjoy the privileged status of a few years ago. State funding for zone development has been frozen or cut back, and plans to develop export processing zones in 14 coastal cities have been scaled down. SEZ leaders are under the gun to produce concrete results in developing exports, controlling corruption, and attracting the right kind of foreign investment. Although SEZ leaders are claiming improved results in developing exports and attracting investment, the zones face tough going as these leaders attempt to justify Beijing's input of both funds and political support.

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